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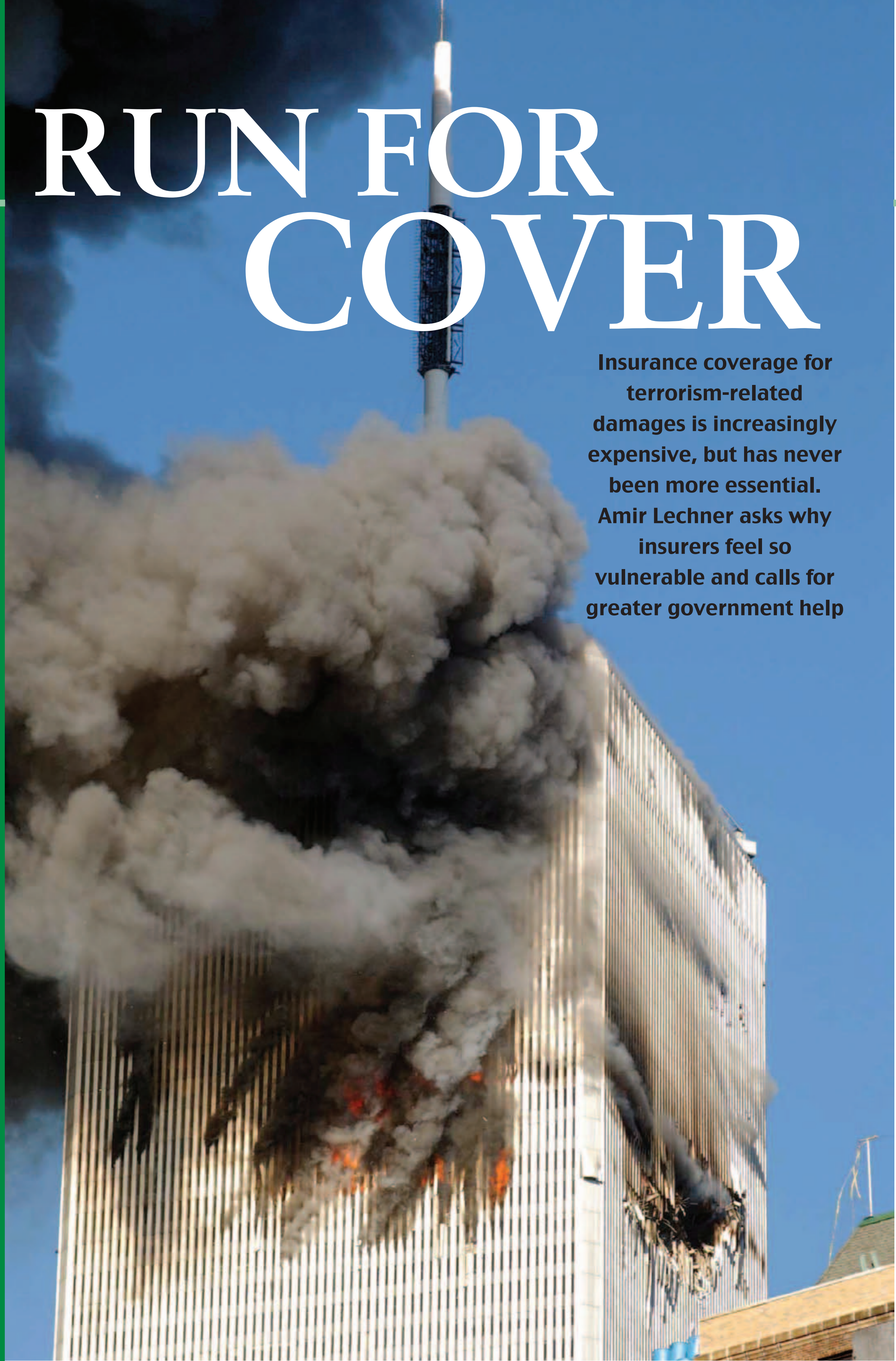
Insurance coverage for terrorism-related damages is increasingly expensive, but has never been more essential. Amir Lechner asks why insurers feel so vulnerable and calls for greater government help



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The 11 September 2001 attacks on New York City and Washington DC, which resulted in devastating economic and long-term health issues, led to the largest-ever property, casualty and business interruption insurance claims, estimated at more than $40billion. The insurance companies covering the World Trade Centre and surrounding damaged properties had sufficient resources to collectively cover the losses from the unforeseen attacks, but many smaller insurance companies were strained. Some were forced into a restructuring process and others were forced to withdraw from the market, leading to changes in the way the insurance industry is now dealing with the growing threat of terrorism.

Insurers were exposed to losses and handled terrorism claims long before the 9/11 attacks. But the overall risk of losses from terrorism and terrorism liability claims was considered to be relatively low by the insurers. As such, both risks were covered by general property policies offered by many insurers. The insurers, overwhelmed by the aftermath of the 9/11 attacks, soon realised that terrorism losses cannot be measured or calculated with the actuarial formulas of the past. They were also pressed by the reinsurance market – insurance providers to the insurance companies themselves – which began to place stringent measures on the insurers that were offering terrorism coverage worldwide. This led the insurers to exclude terrorism from general policy wordings and they began to provide terrorism coverage in separate, special stand-alone policies.

While different companies do not necessarily share the same threat exposure in regard to becoming terrorist targets, global political tensions and increasing violence have widened the threat. Now even companies traditionally considered as having a low-risk exposure to terrorism are being affected. Recent attacks in Europe and the arrests of homegrown terror cells and suspected terrorists throughout the continent would indicate terrorism has spread from its traditional locations in the Middle East and South East Asia. But the threat against Western companies is still much greater there.

Common perception has always been that international companies and other interests recognised as American, British or Israeli are the preferred targets of Islamist terror groups. Yet other countries have recently been targeted, and are likely to remain targets for the foreseeable future. Scandinavian and Dutch companies with international interests that for years enjoyed their governments' perceived neutrality in world conflicts are currently having elevated threats levied against them. This follows the publication of cartoons depicting the Islamic Prophet Mohammed in Dutch and Scandinavian newspapers and the release of an anti-Islam movie in these countries. Chinese companies, which were rarely targeted in the past, are also perceived as having an elevated risk in African nations. This is due to China's increased presence in the continent's oil market. Hostility to Chinese firms is high, especially in Sudan, where China consumes 80 per cent of the oil drilled in the country and in return arms government troops.

It is generally believed that large international conglomerates have a higher risk of becoming a target of terrorists because of their international exposure and the resulting impact on economies and societies.

But a closer look at past targets reveals that in most cases the businesses were targeted because of what they symbolised rather than their size or line of business. As such, small- and medium-sized companies have the potential to become terrorist targets. Furthermore, the increased security measures implemented by many of the international conglomerates around their plants and offices may deter terrorist groups and lead them to target less secure targets of the same national origin.

Recent terrorist attacks around the globe indicate that Islamist terrorist groups have changed their *modus operandi* and are now targeting "soft" targets such as malls, restaurants, hotels and other interests where large numbers of people tend to congregate. Attacks against these targets tend to face few obstacles, produce a large number of casualties and receive a great deal of media attention. In addition to the initial damage, soft target attacks damage economies, as the public will opt to stay at home in the face of the terrorist threat. In Israel, for example, it took years before the public returned to using public transportation, a favourite target of suicide bombers. As such, many businesses located near central areas or locations have the potential to suffer from collateral damage.

Other terrorist organisations with mainly nationalistic agendas – including the Irish Republican Army (IRA), Basque Homeland and Freedom (ETA), the National Front for the Liberation of Corsica (FLNC) – despite being responsible for innocent civilians deaths, aim (or aimed in the case of the IRA) their attacks at causing material and financial damage rather than civilian casualties. For example, the IRA detonated a car bomb near the Baltic Exchange building in London in 1992. Three people were killed in the incident, but it caused damage estimated at around $700million. A year later, the IRA's Bishopsgate Road bombing, in the heart of London's financial district, killed one person and injured 46 others, resulting in close to $1billion in damage. According to some sources, coverage of these attacks led to the near-collapse of Lloyd's of London.

The media and public usually consider the aftermath of a terrorist attack in terms of civilian deaths and injuries. But governments, company executives, security managers and insurers are also assessing the attacks in regard to possible long-term effects, such as property damage, revenue losses and liabilities, and therefore prefer to be covered by appropriate policies. In many cases, small- and medium-size business owners, suffering damage following a terrorist attack, are forced to reinvest or close their businesses altogether. As such, a terrorism policy is likely to help in the recovery process, even if the company suffered only from collateral damage due to being located near the target.

Many critics of these privately-offered terrorism policies claim that they are costly and in many cases are limited to specific events and damages incurred in an attack, forcing the insured parties to purchase additional stand-alone policies to cover all their risks. Extortion, for example, is a growing form of terrorist activity in many nations where rebel activities are widespread, and international and local companies, perceived as wealthy, are victimised. In many cases, extortion

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Exposed: the 1996 London Dockland bombings by the IRA led to huge insurance claims

does not involve human casualties but instead targets property or equipment. But insurers do not tend to cover the threat in their terrorism policies and only offer coverage for the threat under their Kidnap & Ransom, Extortion policies (KRE policies).

In a recent case that took place in the Philippines, two construction companies – one Korean and one Japanese – building the new Bacolod-Silay International Airport in Silay City, were targeted by New People's Army (NPA) rebels. The rebels reportedly demanded a "revolutionary tax" and damaged an estimated P20million (close to $500,000) worth of construction equipment. Coverage for such an attack, though carried out by a terrorist group, would be covered by two stand-alone policies. While the "tax" would be covered under KRE policy, the damaged equipment would still be covered by a Property Terrorism and Sabotage (PTS policies).

When it comes to liability issues in which the insurer needs to establish the probability of terrorists using the products, facilities or materials of a certain company, or of being sued by a third party – and deemed as being responsible by this third party for bodily injury/property loss in the course of a terrorism incident – many factors come into play. Size and international location are not the only factors. In most cases the line of business, products offered and intended consumers, as well as security procedures of the company, will affect the premium amount. Companies with facilities that are considered "critical infrastructure", such as chemical plants or gas and fuel farms or companies dealing with the public, such as airports and other forms of public transportation, are likely to carry higher insurance premiums.

With the growing threat of terrorism, and in order to help develop the private market for terrorism risk insurance, several governments have created policies to help mitigate financial collapse of their economies if targeted by a large-scale attack such as occurred on 9/11. As the government programmes provide coverage to local companies following an attack, companies operating abroad are usually not covered under these programmes. This situation further demonstrates the need for companies with international exposure to obtain private insurance coverage.

PEER REVIEW

Julian Thompson

Many of the public will be all too aware of the requirement imposed on business and property owners to take out terrorism coverage in stand-alone policies – an unwelcome additional burden on the budget. Some may well say "Why me? I am not a target." Even the IRA, and terrorist organisations with similar nationalistic agendas, caused, and continue to inflict, collateral damage to businesses that are by no stretch of the imagination the traditional "target" for such groups. Now the risk is higher. Amir Lechner reminds us that Islamic terrorists deliberately attack soft targets, and smaller companies. A company that congratulates itself on high standards of security may still be in danger of suffering catastrophic damage because of its proximity to a "soft" target.

Amir Lechner is a founding partner of ThreatRate Risk Management LLC, a security and crisis management consulting firm. He served in field intelligence in the Israeli Defence Forces (IDF) until he moved to the United States in 1991, where he served in the security department of the General Consulate of Israel in NYC and the security department of EL AL Israeli Airlines.

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